



BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
MARY ELLIOTT)

For Appellant: Mary Elliott,
in pro. per.

For Respondent: Jean Ogrod
Counsel

OPINION

This appeal is made pursuant to section 18593 of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protest of Mary Elliott against a proposed assessment of additional personal income tax in the amount of \$170 for the year 1974; and pursuant to section 13057, subdivision (a), of the Revenue and Taxation Code in denying her claims for refund of personal income tax in the amounts of \$785 and \$92 for the years 1974 and 1975, respectively.

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The sole issue presented by this appeal is whether appellant has established that respondent's determination of the amount of trust distributions taxable to appellant is in error.

Appellant's appeal involves a proposed assessment for 1974 in the amount of \$170 and two claims for refund in the amounts of \$785 for 1974 and \$92 for 1975. During the appeal period, on the basis of additional information submitted by appellant, respondent recomputed appellant's 1974 liability and now concedes **that** her 1974 deficiency is only \$125.52. Respondent also recomputed appellant's 1975 liability and has determined that appellant made an overpayment for that year in the amount of \$94.46. Should it prevail, respondent has agreed to adjust all of appellant's assessments and claims accordingly. Due to the fact that respondent has recomputed the 1975 liability and found an overpayment in excess of the amount of the claim for refund, we will not address any **contentions regarding the 197-S return in this appeal.**

Appellant is a life beneficiary of a charitable remainder trust established by the Last Will and Testament of her late husband, Ray W. Elliott, who died on August 17, 1971. On August 30, 1973, a Court Order (First Order) was issued which appointed Title Insurance and Trust, Company trustee and ordered distribution of a portion of Mr. Elliott's estate to the trustee, to be administered according to the terms of the trust.

Under the terms of the trust, appellant was to receive \$500 income per month for life, plus cost of living and tax increases, and such additional amounts as the trustee deemed necessary. The payments to appellant were to be made from the net income of the trust, or if the net income was not sufficient, from trust principal.

The First Order also provided that **the** trustee was to pay appellant monthly payments for the period commencing August 17, 1971, and ending **March** 31, 1973. On June 11, 1974, a Final Accounting and Closing Order (Second Order) of Mr. Elliott's estate was issued which ordered the trustee to **pay** appellant monthly payments for the period April through August 1973.

During the trust's first taxable year ended January 31, 1974, the trust reported that it made taxable distributions to appellant in the total amount of **\$17,944.61**. Respondent examined appellant's 1974 return and determined that appellant had understated the amount of trust distributions taxable to her. Respondent issued a deficiency notice which reflected its **determination.**

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Appellant protested the deficiency notice and filed an amended 1974 return. On the amended return appellant claimed a refund of \$785 on the theory that only \$7,242 received by appellant in 1974 was taxable to her because the remainder of payments made to her had been taxed to her husband's estate.

After a meeting with appellant, respondent determined that the proposed assessment should be revised to include appropriate increases in appellant's medical and contributions deductions and that the claim for refund should be denied. After the above meeting, a pretest hearing was held. Respondent reviewed appellant's protest and refund claims and, in accordance with its auditor's recommendation, but contrary to the recommendation of its hearing officer, revised its proposed assessment for 1974 and denied appellant's refund claims. This **appeal** followed.

As a general rule, the income of a trust or estate is taxable to the trust or estate. (Rev. & Tax. Code, § 17742.) Sections 17761 and 17762 of the Revenue and Taxation Code are the basic provisions dealing with the taxability of complex trusts such as the one involved in this **appeal**. Section 17761 provides, in part, that any amount of income required to be distributed currently shall be allowed as a deduction, which deduction shall not exceed distributable net income, in computing the taxable income of the trust or estate. Section 17762 provides that, to the extent any amount distributed to a beneficiary does not exceed distributable net income, the distributed amount shall be included in the gross income of the beneficiary of the trust or estate. For purposes of this appeal, distributable net income can be viewed simply as the taxable income of the trust or estate. (Rev. & Tax. Code, § 17733.)

Appellant argues that because the Ray W. Elliott Estate was taxed on income earned by the estate during the period of administration, she should be taxed on only a portion of the distributions which she received since the estate had already paid tax on this income. Appellant contends that to tax her on the full amount of these distributions constitutes impermissible "double taxation-." Her contention is based on the fact that part of the payments she received from the trust was for the annuity amounts due her prior to the **establishment** of the trust.

Respondent maintains that appellant has not established that its determination of the amount of trust distributions taxable to appellant is in error.

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For the reasons stated herein, we disagree, in part, with respondent's determination.

Respondent bases its determination on the fact that the Ray W. Elliott Trust reported that during its taxable year ended January 31, 1974, it made taxable distributions to appellant in the amount of \$17,944. It notes that this amount represented monthly payments which the trust was required- to make 'for the period' from August 30, 1973, when the trust was funded, to January 31, 1974, the end of the trust's first taxable year, plus actual payments to cover the months after Ray W. Elliott's death and before August 30, 1973, during which "the trust was not funded or functioning." (Emphasis added.) Finally, respondent concludes that "[t]his amount is the same as the trust's distributable net income for the year,"

Taken at face value, we would agree with respondent's determination since it is clear that under the statutory scheme for taxation of complex trusts found in sections 17761 and 17762 of the Revenue and Taxation Code, distributions paid to the beneficiary of a trust, to the extent they do not exceed distributable net income, are taxed to that beneficiary. However, the problem with respondent's determination is that it accepts the distributable net income reported by the trust and equates it with the distribution made to appellant even though the total income generated by the trust during the period it was in existence during its first taxable year was only \$1,045.78.

October 11, 1973, was the actual date funds were first transferred from the estate to the trust. From the date of the transfer until the end of the trust's first taxable year, January 31, 1974, the transferred funds earned income of only \$1,045.78. Thus, it appears from the record in this appeal that for its first taxable year the trust's distributable net income was no more than \$1,045.78. Therefore, the amount of the trust distribution which was taxable to appellant could not have exceeded \$1,045.78. The remainder of the \$17,944.61 distributed to appellant was neither deductible to the trust nor includible in appellant's income because it exceeded the trust's distributable net income. (See Rev. & Tax. Code, §§ 17739, 17761 & 17762.) The distribution received by appellant pursuant to the Second-Order was properly included in her 1975 return;

For the reasons stated above, respondent's action is modified in accordance with this decision.

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O R D E R

Pursuant to the view's expressed in the opinion of the board on file in this proceeding, and good cause appearing therefor,

IT IS HEREBY ORDERED, ADJUDGED AND DECREED, pursuant to section 18595 of the Revenue and Taxation Code, that the action of the Franchise Tax Board on the protest of Mary Elliott against a proposed assessment of additional personal income tax in the amount of \$170 for the year 1974; and pursuant to section 19060 of the Revenue and Taxation Code in denying her claims for refund of personal income tax in the amounts of \$785 and \$92 for the years 1974 and 1975, respectively, be and the same is hereby modified in accordance with respondent's concession and this decision. In all other respects, the action of the Franchise Tax Board is sustained.

Done at Sacramento, California, this **31st** day of January , 1984, by the State Board of Equalization, with Board Members Mr. Nevins, Mr. Dronenburg, Mr. Collis, Mr. Bennett and Mr. Harvey present.

Richard M. Nevins, Chairman
Ernest J. Dronenburg, Jr., Member
Conway H. Collis, Member
William M. Bennett, Member
Walter Harvey*, Member

*For Kenneth Cory, per Government Code section 7.9



In the Matter of the Appeal of)
MARY ELLIOTT)

Upon consideration of the petition filed February 27, 1984, by the Franchise Tax Board for rehearing of the appeal of Mary Elliott, we are of the opinion that none of the grounds set forth in the petition constitute cause for the granting thereof and, accordingly, it is **hereby ordered** that the petition be and the same is hereby denied and that our **order** of January 31, 1984, be and the same **is** hereby affirmed.

<u>Ernest J. Dronenburg, Jr.</u>	, Chairman
<u>William M. Bennett</u>	, Member
<u>Richard Nevins</u>	, Member
<u>Walter Harvey*</u>	, Member
	, Member

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